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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 744

In the Matter of:

FOREST CITY BREWERY, INC.,

Bankrupt

JEROME N. CURTIS, TRUSTEE IN BANKRUPTCY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The memorandum of the Referee in Bankruptcy (R. 9-21) is unreported. The memorandum opin-

ion of the District Court (R. 26) is also unreported. The *per curiam* opinion of the Court of Appeals (R. 33-34) is reported at 178 F. 2d 268.

JURISDICTION

The judgment of the Court of Appeals was entered on December 12, 1949. (R. 32.) By an order dated March 13, 1950, Mr. Justice Reed extended the time for filing a petition for a writ of certiorari to and including April 12, 1950, "if I have the power" (R. 35). The petition for a writ of certiorari was filed on April 11, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether a trustee in bankruptcy who, on order of the bankruptcy court, pays wage claims of former employees of the bankrupt who are entitled to priority in payment under Section 64a(2) of the Bankruptcy Act, as amended, is liable for payment of the income withholding tax imposed by Section 1622 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

These may be found in the Appendix, *infra,* pp. 9-19.

STATEMENT

The material facts were stipulated and are summarized in the Certificate of the Referee on the Government's petition to review the Referee's order (R. 9-11).

In July, 1939, Forest City Brewery, Inc., filed a petition under Chapter XI of the Bankruptcy Act, as amended. Failing to accomplish an arrangement under that chapter, the company was adjudged a bankrupt and the estate proceeded to liquidation (R. 9-10).

A total of 117 claimants filed claims in 1939 for wages earned prior to July, claiming priority by virtue of Section 64a(2) of the Bankruptcy Act, as amended. All claimants affected by the question now at issue had their claims allowed with a finding of priority under Section 64a(2) of the Bankruptcy Act, as amended. The amounts claimed by the several claimants varied but none exceeded the $600 limit imposed by that Section (R. 10). Early in the proceedings, the then acting Referee declared a dividend of 25 per cent upon these claims which was paid without any deduction. No claim is asserted here by the Government by reason of this payment. There was no provision for an income withholding tax at that time. (R. 10.) [1]

[1] The income tax withholding provisions here involved were added to the Internal Revenue Code by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126. The rates of withholding applicable to the payments here involved were fixed by Section 104 of the Revenue Act of 1945, c. 453, 59 Stat. 556. Although the petition for review of the Referee's order (R. 6) and the notice of appeal from the decision of the District Court (R. 27) cite Sections 1400 and 1410 of the Internal Revenue Code, it is clear from the record as a whole that the taxes here involved were imposed under Section 1622 of the Internal Revenue Code, as added by Section 2 (a) of the Current Tax Payment Act of 1943 and amended by the Revenue Act of 1945, and that nobody has been misled by this inadvertent reference to the wrong provisions of the Code.

The 1939 bankruptcy proceedings were closed in 1940. They were reopened in 1945 for the purpose of recovering assets and referred to the present Referee. The new trustee in bankruptcy having recovered a substantial sum, there became available for payment to the prior wage claimants a sum which, without deduction for income withholding taxes, would permit a dividend thereon of 43.8 per cent. A dividend in this amount was declared, and it was because of the declaration of this dividend and its proposed payment that the Government filed its present claim for payment of the income withholding taxes here involved. (R. 10.) The claim of the United States, which listed the name and address of each wage claimant entitled to share in the dividend, the amount proved, the amount of dividend payable, and the income withholding tax due on the dividend, was filed March 19, 1948 (R. 2-5).

As stated above, the United States made no claim for any tax by reason of the 25 per cent dividend paid to wage claimants prior to the closing of the bankrupt estate in 1940; and the United States is not here claiming income withholding taxes in those cases—of which there are some—where the wage claimant has, in good faith, assigned his wage claim to another and the present claimant holds as an assignee (R. 10).

By consent of the parties, the trustee in bankruptcy was directed to pay the dividend declared less the amount of the tax claimed, respectively,

upon the allowed claims, the amount retained by the Trustee applicable to the tax to be held by him pending the final determination of the question here involved (R. 7, 10).

The Referee denied the claim of the United States (R. 8), and filed an opinion elaborating his reasons for so doing (R. 11-21).

The District Court affirmed the order of the Referee on the ground that (1) the trustee is not an employer within the meaning of the Current Tax Payment Act of 1943 and in paying dividends on claims for wages he is not paying wages; and (2) the claim asserted by the United States cannot be sustained as a cost of administration under Section 62 of the Bankruptcy Act, as amended, for the reasons assigned by the Referee in his opinion (R. 26-27).

The United States appealed from this decision to the Court of Appeals for the Sixth Circuit (R. 27), which reversed the District Court (R. 32). The Court of Appeals held that a trustee in bankruptcy who makes payments in respect of wages earned by the bankrupt's employees before the bankruptcy is an employer for income withholding tax purposes and is liable for the payment of such taxes where there is no proof that the wage earners had paid sufficient income taxes to discharge the withholding taxes. It did not reach the question whether the withholding taxes could properly be treated as expenses of administration. (R. 34.)

ARGUMENT

Section 1621 (d)(1) of the Internal Revenue Code (Appendix, *infra*, p. 11) defines as an employer the person for whom an individual performs services, *except that* if that person does not have control of the payment of wages the term means the person having such control. As the Court of Appeals for the Eighth Circuit ruled in *United States* v. *Fogarty*, 164 F. 2d 26, a trustee in bankruptcy comes within the latter definition. The purpose of Congress in adopting the statutory definition of "employer" which it did was to treat the actual payer of the remuneration as the employer for withholding and payment purposes. S. Rep. No. 221, 78th Cong., 1st Sess., pp. 19-20 (1943 Cum. Bull. 1314, 1329); H. Rep. No. 401, 78th Cong., 1st Sess., pp. 23-24 (1943 Cum. Bull. 1283, 1301); H. Conference Rep. No. 510, 78th Cong., 1st Sess., pp. 30-31 (1943 Cum. Bull. 1351, 1353). There is no question that the creditors to whom the wages in question herein were due were employees within the statute.

Petitioner argues (Pet. 6) that the decisions in this and the *Fogarty* case distort Sections 57n and 64a of the Bankruptcy Act, as amended (Appendix, *infra*, pp. 13-15). The fallacy of petitioner's position on this score is that those sections contemplate taxes legally due and owing by the bankrupt. Section 57n thus provides for timely filing of claims and Section 64a provides for priority. But the taxes here involved are taxes due and

legally owing by the Trustee as administrator of the bankrupt estate, for no liability for withholding taxes arises until the wages from which they are to be drawn are paid, regardless of when the services may have been performed. Sec. 1622 of the Internal Revenue Code; Treasury Regulations 116, Sec. 405.301 (Appendix, *infra,* pp. 18-19); *United States* v. *Fogarty,* 164 F. 2d 26 (C. A. 8th). Thus, since no tax claim arose until after the bankrupt's estate came into the hands of the Trustee, the claim does not come within the provisions for priority and filing of claim (Secs. 57n and 64a) of the Bankruptcy Act.

Petitioner complains (Pet. 6-7) that he is left in the dark as to the status of withholding taxes required to be paid by the trustee. But for the Government to prevail, its claim need not be classified for purposes of the Bankruptcy Act. The Government, can, and should, be paid that part of the preferred wage claims that the statute (Sec. 3661 of the Internal Revenue Code (26 U. S. C. 1946 ed., Sec. 3661)) directs are to be retained as trust funds out of wages by the person or officer who has control of the wages. Thus treated, payment to the Government is a primary obligation imposed by statute upon the trustee—an obligation to retain and pay to the Government, not a part of the bankrupt's estate as such, but a part of the claims allowed others as wages. *In re Haynes,* 88 F. Supp. 379 (D. Kan.); Internal Revenue Code, Sec. 1623;

Treasury Regulations 116, Sec. 405.301. Thus considered, application of the Internal Revenue Code does in no way cause diminution of the bankrupt's estate nor affect the amounts distributable to creditors.

Petitioner's complaint (Pet. 7-8) with regard to the rights of the wage claimants is groundless. The amount deducted and withheld by an employer—in this case the trustee—represents a payment of tax on behalf of the employee, who is entitled to credit therefor in the computation of his ultimate liability for the taxable year involved (Internal Revenue Code, Sec. 35 (Appendix, *infra*, p. 9)), and if the amount deducted and withheld is excessive, it is refunded to the employee (Secs. 322 and 1622(f) (Appendix, *infra*, pp. 9-10, 12)).

CONCLUSION

The decision below was clearly correct. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
A. F. PRESCOTT,
EDWARD J. P. ZIMMERMAN,
Special Assistants to the Attorney General.

MAY, 1950.

APPENDIX

Internal Revenue Code:

SEC. 35 [as added by Sec. 172, Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 3, Current Tax Payment Act of 1943, c. 120, 57 Stat. 126]. CREDIT FOR TAX WITHHELD ON WAGES.

The amount deducted and withheld as tax under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit to the recipient of the income against the tax imposed by this chapter for the taxable year beginning in such calendar year. If more than one taxable year begins in any such calendar year such amount shall be allowed as a credit against the tax for the last taxable year so beginning.

(26 U. S. C. 1946 ed., Sec. 35.)

SEC. 322 [as amended by Sec. 172 (e), Revenue Act of 1942, *supra,* Sec. 4 (a), Current Tax Payment Act of 1943, *supra,* and Sec. 6 (b), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231]. REFUNDS AND CREDITS.

(a) *Authorization.*—

(1) *Overpayment.*—Where there has been an overpayment of any tax imposed by this chapter, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(2) *Excessive Withholding.*—Where the amount of the tax withheld at the source under Subchapter D of Chapter 9 exceeds the taxes imposed by this chapter against which the tax so withheld may be credited under section 35, the amount of such excess shall be considered an overpayment.

* * * * *

(b) *Limitation on Allowance.*—

(1) *Period of Limitation.*—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * * * *

(26 U. S. C. 1946 ed., Sec. 322.)

SEC. 1621 [as added by Sec. 2, Current Tax Payment Act of 1943, *supra*]. DEFINITIONS.

As used in this subchapter—

(a) *Wages.*—The term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium

other than cash; except that such term shall not include remuneration paid—

* * * * *

(c) *Employee.*—The term "employee" includes an officer, employee, or elected official of the United States, a State, Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

(d) *Employer.*—The term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for the purposes of subsection (a)) means the person having control of the payment of such wages; and

(2) in the case of a person paying wages on behalf of a non-resident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for the purposes of subsection (a)) means such person.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1621.)

SEC. 1622. [as added by Sec. 2, Current Tax Payment Act of 1943, *supra*]. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to the greater of the following:

* * * * *

(d) *Tax Paid by Recipient.*—If the employer, in violation of the provisions of this subchapter, fails to deduct and withhold the tax under this subchapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

* * * * *

(f) *Refunds or Credits.*—

(1) *Employers.*—Where there has been an overpayment of tax under this subchapter, refund or credit shall be made to the employer only to the extent that the amount of such overpayment was not deducted and withheld under this subchapter by the employer.

(2) *Employees.*—For refund or credit in cases of excessive withholding, see section 322 (a).

* * * * *

(26 U.S.C. 1946 ed., Sec. 1622.)

SEC. 1623 [as added by Sec. 2, Current Tax Payment Act of 1943, *supra*]. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment.

(26 U.S.C. 1946 ed., Sec. 1623.)

Bankruptcy Act of 1898, c. 541, 30 Stat. 544 [as amended by Sec. 1 of the Act of June 22, 1938, c. 575, 52 Stat. 840]:

SEC. 57. *Proof and Allowance of Claims.*—

* * * * *

n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: * * *

(11 U.S.C. 1946 ed., Sec. 93.)

SEC. 64. *Debts Which Have Priority.*— a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the filing fees paid by creditors in

involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the

reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

* * * * *

(11 U.S.C. 1946 ed., Sec. 104.)

Treasury Regulations 116, promulgated under the Internal Revenue Code:

Sec. 405.1. *Wages Paid on or After January 1, 1945.*—These regulations apply to all wages (as defined in section 1621) paid on or after January 1, 1945, regardless of when such wages were earned. Thus, if an em-

ployee is paid wages on January 1, 1945, for services performed during 1944 or any preceding year, withholding of the tax at source on such wages shall be subject to these regulations.

* * * * *

Sec. 405.101. *Wages.*—(a) *In General.*—The term "wages" means all remuneration for services performed by an employee for his employer unless specifically excepted under section 1621 (a) or section 1622 (g). See sections 405.102 and 405.204.

The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

* * * * *

Remuneration for services, unless such remuneration is specifically excepted by the statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

* * * * *

Sec. 405.105. *Employer.*—The term "employer" means any person for whom an individual performs or performed any service,

of whatever nature, as the employee of such person.

It is not necessary that the services be continuing at the time the wages are paid in order that the status of employer exist. Thus, for purposes of withholding, a person for whom an individual has performed past services for which he is still receiving wages from such person is an "employer."

If the person for whom the services are or were performed does not have legal control of the payment of the wages for such services, the term "employer" means (except for the purpose of the definition of "wages") the person having such control. For example, where wages, such as certain types of pensions or retired pay, are paid by a trust and the person for whom the services were performed has no legal control over the payment of such wages, the trust is the "employer."

* * * * *

It is a basic purpose to centralize in the employer the responsibility for withholding, returning, and paying the tax and furnishing the statements required under section 1625. The foregoing two special definitions of the term "employer" are designed solely to meet unusual situations. They are not intended as a departure from the basic purpose.

* * * * *

The term "employer" embraces not only individuals and organizations engaged in

trade or business, but organizations exempt from income tax, such as religious and charitable organizations, educational institutions, clubs, social organizations and societies, as well as the governments of the United States, the States, Territories, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions.

Sec. 405.301. *Liability for Tax.*—The employer is required to collect the tax by deducting and withholding the amount thereof from the employee's wages as and when paid, either actually or constructively. As to when wages are constructively paid, see section 405.1. * * *

Every person required to deduct and withhold the tax under section 1622 from the wages of an employee is liable for the payment of such tax whether or not it is collected from the employee. If, for example, the employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of the tax. However, if the employer in violation of the provisions of section 1622 fails to deduct and withhold the tax, and thereafter the income tax against which the tax under section 1622 may be credited is paid, the tax under section 1622 shall not be collected from the employer. Such payment does not, however, operate to relieve the employer from liability for penalties or additions to the tax for failure to deduct and withhold within the time prescribed by law or regulations made

in pursuance of law. The employer will not be relieved of his liability for payment of the tax required to be withheld unless he can show that the tax against which the tax under section 1622 may be credited has been paid.

The amount of any tax withheld and collected by the employer is a special fund in trust for the United States.

* * * * *

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